

ELECTRICITY OVERSIGHT

BOARD MEETING

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

HELD AT THE STATE CAPITOL, ROOM 447

THURSDAY, JUNE 29, 2000

10:07 A.M.

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Reported by:

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CAPITOL REPORTERS (916) 923-5447

A P P E A R A N C E S

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MICHAEL A. KAHN - Chairperson

BRUCE G. WILLISON - Member

GARY HEATH - Executive Deputy Director

ERIK SALTMARSH - Chief Counsel

SENATOR DEBRA BOWEN

ANNA FERRERA - Senator Bowen's Office

ASSEMBLYMAN WRIGHT

CAROLYN VEAL-HUNTER - Assemblyman Wright's Office

SENATOR PEACE

JOHN ROZSA - Senator Peace's Office

LORETTA LYNCH - President CPUC

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1 THURSDAY, JUNE 29, 2000, 10:07 A.M.

2 SACRAMENTO, CALIFORNIA

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4 CHAIRMAN KAHN: We'll get started. Assemblyman
5 Wright is in a caucus and will be joining us in a bit. My
6 name is Michael Kahn. And I am the Chairperson of the
7 Electricity Oversight Board. And I called this meeting of
8 the Board to order.

9 On my left is Senator Bowman and with her is Anna
10 Ferreera and Assemblyman Wright will be joining us. On my
11 right is EOB Member Bruce Willison. I had asked the
12 President of the CPUC Loretta Lynch to join us today. And
13 she has graced us with her presence. And she is invited
14 to join us anytime she can put up with our meeting. And
15 we love to have you.

16 I would like to make a couple of preliminary
17 remarks. We have a very full agenda including amendments
18 to the bylaws of the ISO and the Power Exchange and
19 appointments also to the Power Exchange. What I'm going
20 to try to do is we have a fairly extensive closed session
21 agenda. And what I would like to do is put all of that at
22 the end of the meeting so that those of you who are
23 interested in the public part can see it and don't have to
24 stay around.

25 However, we will reconvene after the private

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1 session to take action pursuant to private session in
2 terms of a couple of elections and maybe a couple of other
3 items. And there are those of you, I don't know who you
4 are ask, but people we will ask to stick around for the
5 private session to help us out.

6 Just one other comment about today's session and
7 the last few weeks. For all of us, the last few weeks
8 have been tumultuous. And there's been a lot of hard work
9 done, especially I know the folks at the ISO have been
10 working hard trying to deal with the problems that Mother
11 Nature has created.

12 I am hopeful that in this dialogue, and I know
13 the ISO had a long meeting last night, the Board did, I am
14 hopeful that what we're here about is problem solving and
15 not finger pointing. The goal here is to try our best to
16 work through the problems. I know there are very strongly
17 held feelings.

18 I know there are a lot of stakeholders who have
19 big interests, but at the end of the day, especially we up
20 here have an obligation to try to do what's best for the
21 citizens of the State. And I don't think it's best for
22 the citizens to create an acrimonious environment.
23 Finally, I would like to thank Jan for keeping me advised
24 as he has about what's going on at the ISO during this
25 difficult period.

1 Bruce, would you like to make any opening
2 statements?

3 MEMBER WILLISON: No.

4 CHAIRMAN KAHN: Debra?

5 SENATOR BOWEN: I'd just like to say that a part of
6 what we have to do here actually has to do with the
7 long-term viability of retaining a competitive market. If
8 we see severe price spikes, concerns about liability, and
9 the like, I think it would be very difficult politically
10 to make the argument that the switch to a competitive
11 market is a success.

12 I think we're very like a strong pressure. So
13 for those who believe in the power of competitive markets,
14 I think it's very important to understand that every
15 constituent of every voting member of the Legislature pays
16 an electricity bill every month.

17 CHAIRMAN KAHN: Amen. Mr. Rozsa, welcome.
18 Would you like to make any opening remarks?

19 MR. ROZSA: I hadn't heard the opening remarks of
20 the other members. Excuse me for being late here,
21 Chairperson.

22 I think that the concept of the stakeholder board
23 was tested last night and flunked. Some people think that
24 these things are a matter of opinion, but when the sun is
25 shining and somebody says that it's dark, that's not a

1 matter of opinion.

2 CHAIRMAN KAHN: The first order of business is the
3 approval of the minutes. They're in our notebooks. Do I
4 have a motion?

5 MEMBER WILLISON: Move for approval.

6 CHAIRMAN KAHN: Second. Any discussion? All in
7 favor say, "aye."

8 MEMBER WILLISON: Aye.

9 CHAIRMAN KAHN: Passes two to nothing.

10 Mr. Heath, the manager report.

11 EXECUTIVE DIRECTOR HEATH: Thank you, Mr. Chairman,
12 Members, and guests. I'll make my report very short.
13 Today, obviously, as has been communicated by
14 Mr. Chairman, we have a lengthy agenda and we want to get
15 to some more substantive issues today.

16 As you're aware, the Governor sent to the
17 Oversight Board and to the Public Utilities Commission a
18 directive to investigate the San Francisco outages that
19 occurred in the week of June 12th. I'd just like to at
20 this point say that we are working very cooperatively with
21 the PUC on these matters.

22 We're meeting regularly with them. And as early
23 as this morning, we had meetings with the ISO CEO
24 President Terry Winter; and counsel,
25 Mr. Charlie Robinson, to go over some information

1 requests. We are working with the PUC staff on developing
2 additional requests. I'd like to on that point have
3 further discussion with members related to that
4 investigation.

5 Second part of our report is on SB 1388. I'll
6 bring this to the Members' attention that bill in its
7 current form does, in fact, have a duty or responsibility
8 that will be given to the EOB along with the PUC to
9 represent the State in the FERC proceedings related to
10 cost of the transmission planning that the transmission
11 owners would be undertaking in the future and to make sure
12 that the costs in those transmission plannings are getting
13 fair treatment there.

14 Current status on vacancies, since our last
15 meeting we have hired three people. We also at this point
16 have two offers out for additional positions. We hope to
17 have a full compliment on staff shortly.

18 Last thing I wanted to mention to you, we were
19 planning to have a report to the Fiscal Committee today in
20 regard to our expenditures this past year and our future
21 allocations, I'd like to defer that until our next Board
22 meeting and I'll also meet with Mr. Willison to go over
23 those numbers. So that concludes the management report at
24 this time. Other than we'll be asking for a closed
25 session at the end of today's meeting.

1 Thank you, Mr. Chairman.

2 CHAIRMAN KAHN: I apologize.

3 Mr. Willison, you comfortable with that?

4 MEMBER WILLISON: Yes. We discussed that. I think
5 that's the best plan given the other things that staff is
6 working on at this time.

7 EXECUTIVE DIRECTOR HEATH: One point of
8 clarification, I apologize for this. It is important to
9 note that the letter that the Governor sent on June 15th
10 was to appointees, the Chairman of the Oversight Board as
11 well as the President of the CPUC to the appointees. I
12 just wanted to make that clarification. Thank you.

13 CHAIRMAN KAHN: Okay. Hi, Carol, come on in. We
14 are just finishing the management report and before I get
15 there, does anybody have any questions for the Executive
16 Director?

17 MEMBER WILLISON: No.

18 CHAIRMAN KAHN: Okay. Thank you very much,
19 Mr. Heath. Let's now turn to the Chief Counsel report.

20 Mr. Saltmarsh.

21 CHIEF COUNSEL SALTMARSH: Thank you, Mr. Chairman.
22 Because of the agenda today, the one item that I felt it
23 is appropriate to give a report from the legal office on
24 was an update on the status of price capping, price
25 capping authority in the ISO administered markets.

1 I have received a series of memorandums over the
2 last several months related to that matter and what was
3 going on with it. I have asked Ms. Jubien from the legal
4 office to walk you through a very brief update in
5 anticipation that the ISO will also be addressing the
6 Board later on during the meeting on what action was taken
7 last evening with respect to price caps.

8 So I'll turn it over to Ms. Jubien just to give
9 you an update on some of the factors surrounding the price
10 capping authority.

11 CHAIRMAN KAHN: Welcome, Ms. Jubien.

12 MS. JUBIEN: Good morning, Chairman Kahn, President
13 Lynch, Members, and honored guests.

14 There are two bid cap issues that I'd like to
15 bring to your attention. First is the bid cap that will
16 be in place for the balance of the summer. Up until last
17 evening, it was \$750 per megawatt -- per megawatt hour.
18 Last evening the ISO governing board voted to lower that
19 to \$500 effective July 1st.

20 The other big cap item that I wanted to bring to
21 your attention is the current bid cap authority that the
22 ISO has expires November 15th. Unless the ISO files an
23 extension of authority, there will be no bid capping
24 authority after November 15th. The ISO is planning to
25 address that at their September 6th and 7th meeting for

1 potential filing before September 15th.

2 We are concerned that, although it is within the
3 60-day window of the normal FERC period of consideration,
4 that that, in fact, is not sufficient time for the FERC to
5 consider an additional request, nor do we think it's
6 enough time for the ISO governing board between September
7 6th and 7th through the 15th to consider what appropriate
8 action they should be taking.

9 CHAIRMAN KAHN: Have you taken this up with ISO
10 management?

11 MS. JUBIEN: We have not taken it up directly with
12 ISO management. And we will -- obviously, are taking it
13 up, to some extent, today we would like to ask the ISO to
14 comment on that issue.

15 CHAIRMAN KAHN: Well, they're right behind you.

16 MS. JUBIEN: Yes. And I know they're going to
17 comment on the bid cap issues later in the meeting.

18 CHAIRMAN KAHN: I think that there isn't any
19 question that the ISO, at least, ought to make itself
20 ready to comply with all requirements of FERC. And if
21 FERC wants to see this thing earlier, then they ought to
22 think about that doing. I assume that you'll work with
23 them to accomplish all of that.

24 MS. JUBIEN: We'll certainly let our views be known.

25 CHAIRMAN KAHN: Okay. I also understand from the

1 perspective of the State of California, the only action
2 the State of California is going to take with respect to
3 this is to encourage the ISO to go to the FERC. Is that
4 right?

5 MS. JUBIEN: That's certainly the manner in which
6 we've conducted ourselves. I'm not going to rule out that
7 on the question, that we couldn't take some other action
8 by way of direct complaint to the FERC.

9 CHAIRMAN KAHN: All roads lead to the FERC.

10 MS. JUBIEN: I believe in this matter, all roads
11 lead to the FERC.

12 CHAIRMAN KAHN: Okay. Anything else that you'd like
13 to add?

14 MS. JUBIEN: No, sir.

15 CHAIRMAN KAHN: Mr. Saltmarsh?

16 CHIEF COUNSEL SALTMARSH: Nothing further,
17 Mr. Chairman.

18 CHAIRMAN KAHN: Anybody have any questions or
19 comments?

20 President Lynch?

21 MS. LYNCH: I would just encourage the EOB to
22 request of the ISO that they apply for an extension as
23 well. I'm certainly in favor with that.

24 CHAIRMAN KAHN: Okay. Perhaps, Mr. Winter, when you
25 folks talk about bid caps you can tell us what you think

1 in that regard. Mr. Robinson doesn't have enough to do
2 anyway, so he can get on it.

3 Anything else, Mr. Saltmarsh, to report?

4 CHIEF COUNSEL SALTMARSH: No. I've nothing that I'd
5 like to include in this agenda item.

6 CHAIRMAN KAHN: Okay. Thank you. That brings us to
7 ISO and Power Exchange governance matters. And the first
8 issue is -- actually, Mr. Heath, so I don't drop the ball,
9 or break the egg, or whatever, why don't you lead us
10 through these things?

11 EXECUTIVE DIRECTOR HEATH: I will do my best. At
12 this point, Ms. Catherine George, Staff Counsel for EOB,
13 will be presenting this portion of the Board's meeting
14 agenda. She'll be joined at some point by Mr. Rich Jacobs
15 from the CAISO as well as Mr. Scott Rasmussen with the
16 California Power Exchange.

17 For your convenience -- I hope for your
18 convenience, we divided up in sections certain actions
19 that will be taken on the matters related to the bylaws as
20 well as the issues dealing with appointments, staggering
21 of term appointments. And then finally, we'll also take
22 up the appointment of Mr. John Geesman.

23 At this point I'll turn it over to Ms. George and
24 she can take you through it.

25 CHAIRMAN KAHN: Perhaps, before Ms. George comments,

1 welcome.

2 MS. GEORGE: Thank you.

3 CHAIRMAN KAHN: Mr. Rozsa, you would like to
4 comment?

5 MR. ROZSA: Mr. Chairman, I'd like to suggest that
6 the Board defer any action, any bylaw changes, or any
7 nominations, or any confirmations of nominations, or
8 anything having to do with the bylaws or stakeholders of
9 these corporations, the ISO and the PX, until the next
10 meeting.

11 CHAIRMAN KAHN: Because?

12 MR. ROZSA: I think that last night's performance of
13 the stakeholder board of the ISO calls into question the
14 capability of these entities to represent the people of
15 California in a responsible way. And that by confirming
16 or endorsing recommendations that these entities have made
17 at this particular point, gives them an approval from the
18 State that I don't think the State is prepared to give at
19 this point.

20 CHAIRMAN KAHN: Ms. Hunter, do you know if
21 Assemblyman Wright has an opinion on this matter or any
22 matter?

23 MS. VEAL-HUNTER: I haven't spoken to him on this
24 matter specifically since I am just becoming aware of it,
25 but I do know that the actions of the Board last night did

1 not confirm what he would have wished to have taken place.
2 I think he has sent a letter on representing his desire,
3 his concern about some of the recent actions and the
4 impact on California's ratepayers. So I probably don't
5 think it should be discussed today.

6 CHAIRMAN KAHN: Okay.

7 Ms. Ferrera?

8 MS. FERRERA: I, obviously, didn't have a chance to
9 talk to her about this either, but I know she was prepared
10 to deal with this matter today. So I'd have to talk with
11 her about it. Again, another letter was sent from our
12 shop on the price cap. And I'd have to ask her about it.

13 CHAIRMAN KAHN: Senator Bowman had to go to the
14 floor to vote.

15 MS. FERRERA: She'll be right back.

16 CHAIRMAN KAHN: She'll be right back. We'll at
17 least take no action until we hear from her. I guess I'd
18 like to hear from you, Ms. George, before we discuss the
19 question Mr. Rozsa raised, about the prejudice to the ISO
20 and the Power Exchange if we decide to defer.

21 MS. GEORGE: Certainly, I can try to address that.
22 Most of the governance matters before you today pertain to
23 the California Power Exchange and not the California
24 Independent Operator.

25 And there are two bylaw amendments that pertain

1 to the ISO, neither of which I believe is critical. They
2 could indicate a different opinion, but I don't think
3 either of them is critical at this point to their
4 operations.

5 The other matters pertaining to the California
6 Power Exchange, I think the most critical is the
7 appointments. They have already confirmed and selected
8 their governors, the governors that the California Power
9 Exchange has authority over. And they're prepared to take
10 their seats beginning July 1st.

11 They've requested that we also act on the
12 governors being confirmed so that they can take their
13 seats simultaneously on July 1st as well. So if we do not
14 act on the appointments today, there would be some delay,
15 obviously, in when the governors who are appointed will be
16 taking their seats, whether the Power Exchange would then
17 delay commencement dates of their governors, I'm not
18 certain whether they would. I know that they would like
19 to have commencement dates for all governors. And they
20 have an orientation set up on July 19th for the governors.

21 In terms of the other matters, the bylaw matters
22 before you in item 4-C-3, I don't believe any of those are
23 critical. Again, Mr. Rasmussen from the Power Exchange
24 may have a different --

25 CHAIRMAN KAHN: A lot of them seem to say, "Confirms

1 current practice."

2 MS. GEORGE: Yes. Let me see what else there might
3 be. The resolution that would establish the effective
4 date of July 1st, if that does not get acted on today it
5 would require another amendment at the California Power
6 Exchange to change the date, the commencement date that
7 would then come before our Board. That would add
8 additional delay.

9 The staggered terms policy is another item before
10 you. That pertains -- if there's a delay on the
11 appointment of the governors, the staggered term policy
12 would also be delayed. But if the Board were to go
13 forward and act on the appointments it would also need to
14 act on the staggered term issues.

15 CHAIRMAN KAHN: Mr. Heath, Mr. Saltmarsh, do you
16 have any advice for us on this?

17 EXECUTIVE DIRECTOR HEATH: We'll look to the legal
18 advice at this point.

19 CHIEF COUNSEL SALTMARSH: I do not have any advice
20 that I would offer that I think is based on some
21 overriding legal consideration. I think it is
22 fundamentally a policy consideration.

23 Clearly these entities have interests in getting
24 those matters confirmed. But the Board ultimately is in
25 line to confirm, but I do not think I am aware of a legal

1 reason that drives one out in a compelling way.

2 CHAIRMAN KAHN: With the permission of the people on
3 the dais, what I'd like to do is give the ISO and the
4 Power Exchange on the -- the question is -- I'll just tell
5 you that I'm in the same position as Senator Bowman and I
6 believe Mr. Willison is also, we have done our homework
7 and we're ready to deal with this, and we just learned of
8 this request right now. On the other hand, it's our
9 inclination to take these requests very seriously.

10 So we would like your opinion. Mr. Rasmussen,
11 you came up first, why don't you share your view about the
12 prejudice, if any, the Exchange will suffer if we delay
13 this.

14 MR. RASMUSSEN: Thank you, Mr. Chairman, and
15 President Lynch, good morning. And, staff, good morning.

16 I agree with Ms. George and Mr. Saltmarsh from a
17 legal point of view, things would have be amended and
18 presented a little differently in terms of the July 1
19 effective date for the terms, but that could be done.

20 What would ensue, however, in terms of the
21 confirmations of our governors would be a kind of dead
22 period of uncertainty. In July we have a meeting
23 scheduled for the 19th and 20th. Hopefully, we were
24 anticipating to orient the new governors, to seat them,
25 compose our committees, and get business started.

1 If we don't act on the confirmations, we will go
2 another period of time and kind of go into an inability to
3 act, practically speaking is what could happen. So I
4 would definitely encourage the Board to take up the
5 confirmations.

6 In terms of the bylaw amendments, we can live
7 without having action taken on those today. So that would
8 be fine to defer those, but I would strenuously urge in
9 order to get business going, that the confirmations be
10 undertaken.

11 CHAIRMAN KAHN: Well, would you literally be without
12 a board?

13 MR. RASMUSSEN: We would under the Corporation's
14 code, continue to have the Board act until the new chairs
15 are actually -- or the new governors are actually seated.
16 We would be -- however, what we have now, you know, is
17 people who are waiting to come on. We have a certain
18 degree of attrition in those that are coming off the Board
19 who believe they no longer have an active role to play.

20 CHAIRMAN KAHN: A lot of the appointments are, as I
21 recall, people who aren't getting a new term and are
22 currently seated.

23 MR. RASMUSSEN: Incumbents.

24 CHAIRMAN KAHN: Right.

25 Ms. Ferrera, do you have any comments?

1 MS. FERRERA: I was just going to say that I don't
2 think it would make any sense to appoint the board
3 members, or approve the members and not the bylaws. I
4 don't think it make sense to do that, especially since
5 part of the problem is an issue before the Board.

6 CHAIRMAN KAHN: Mr. Jacobs, did I remember
7 correctly?

8 MR. JACOBS: Yes, Mr. Chairman. Thank you, Members.
9 The ISO is in a slightly different position than the Power
10 Exchange. We're about a month behind their election
11 processes. We just completed the first stage of our
12 board's election procedures yesterday evening before the
13 price cap decision.

14 The ISO's bylaws amendments before you this month
15 are not hot and critical at this point to the ISO. While
16 we would like to get the guidance, give you some
17 explanation of what's happening, frankly, is our
18 concurrence of the opinion of your staff on the two issues
19 before you.

20 There's no criticality to doing that this month
21 versus next month. Next month we'll come before you with
22 a panel of accompanies. At that point I'll probably have
23 similar opinions about it as Mr. Rasmussen which is that
24 that be the desire at that point. That's when the time
25 sensitivity will likely arise.

1 CHAIRMAN KAHN: Thank you very much.

2 Mr. Willison, your pleasure?

3 MEMBER WILLISON: Well, I'm trying to think of how
4 we might prejudice our future actions by either moving or
5 not moving today. It seems to me that we've had these
6 issues before us and have gone through two or three
7 iterations. And as you indicated, I am prepared to hear
8 them and to move on them.

9 And as I say, in consideration of the gentleman's
10 comments, I'm not sure how we might prejudice our future
11 actions, or minimize our latitude by certainly approving
12 the bylaws at this time and if not all of the things that
13 are coming before us here.

14 CHAIRMAN KAHN: That was a timely entry.

15 Senator Bowman, Mr. Rozsa has made the suggestion
16 that we defer acting on the governance issues relating to
17 ISO and the Power Exchange, because in his opinion that
18 might be considered to be an endorsement of activities
19 that he believes were inappropriate and not in the best
20 interests of the people.

21 And I have asked the Power Exchange and the ISO
22 to tell us if there was any prejudice for not going
23 forward, delaying. Mr. Jacobs -- and they're all aware
24 that we're all ready to do this if we need to.

25 Mr. Jacobs has advised us that the ISO's position

1 is such that a delay to the next meeting won't prejudice.
2 Mr. Rasmussen, who you'll recall was before the Board
3 before, has suggested as to the bylaws there wouldn't be a
4 problem delaying. In fact, as I pointed out, a lot of
5 practices are just confirmation of current practice.

6 But as to the members, that might cause some
7 dislocation, because certain members are waiting to get
8 off the Board and other members are waiting to join.
9 However, as I understand it under the California law,
10 technically the Power Exchange would still be able to
11 function.

12 So the issue before the House is whether we
13 should defer action, or -- whether we should defer. We
14 would like your view.

15 SENATOR BOWEN: Actually, the same course of action
16 had occurred to me, but then I was concerned about the
17 operational results of that. And it seems to me that at
18 this point the Senate and the Legislature is going to need
19 to review the composition of the ISO and the PX boards
20 anyway.

21 So I don't think that we will send the message
22 that -- or given the satisfaction that we have established
23 the governance members is in the best interest of the
24 California ratepayers simply by taking this action. If it
25 turns out -- if there's no reason not to delay, then

1 there's no reason not to delay.

2 CHAIRMAN KAHN: Okay.

3 Mr. Willison, would you like to make a motion, or
4 would you like to proceed, since the law has devolved
5 while you and I as the only voters?

6 MEMBER WILLISON: Well, I'll let you know the items
7 broken out separately, I guess in light of the comments
8 made that there would be dislocation with regard to the
9 nominees, but that would not be a critical issue.

10 And in light of the fact that the bylaw changes
11 for either the PX or the ISO would not have an impact, an
12 operating impact, my comments are basically that given the
13 discussion here and the fact that it would be a matter of
14 dislocation to the nominees, but not a critical issue, and
15 the delaying on the bylaws would really have no impact at
16 this time, if I was convinced that we could address these
17 issues by the next meeting and move on them and be able to
18 settle these things in order to allow for the best
19 operating practices as they should be with the board with
20 the proper guidelines and bylaws, then I would move to
21 defer action on these items at this point.

22 CHAIRMAN KAHN: And I would second that.

23 Do you have any further comments on that?

24 MEMBER WILLISON: No.

25 CHAIRMAN KAHN: I will just add the comment that we

1 have in the last -- the tenure since I have been here at
2 EOB, have been fortunate to have a great amount of
3 cooperation from, and assistance from our legislative
4 members and their staffs.

5 And I think in respect of that cooperation and
6 the way this Board has been functioning since Mr. Willison
7 and I joined, I think Mr. Willison's motion is well-taken.
8 It should not be taken in any way as a reflection on the
9 merits, from my perspective.

10 We were prepared to decide on this. On the other
11 hand, I think we have an obligation to let the Legislature
12 consider what their reaction to last night's comments are
13 and weigh in. So I'll call the question:

14 All in favor?

15 MEMBER WILLISON: Aye.

16 CHAIRMAN KAHN: Aye. Passes two to nothing.

17 Mr. Rasmussen, Mr. Jacobs, I'm sorry, you'll have
18 to come back again. Thank you for your goodwill about it.

19 With that -- I guess if I was in sports center I
20 could make a quip, something like, "More beer for us." It
21 means, in effect, that we have more time to discuss the
22 substantive issues, which I think in some ways is a
23 blessing, because we do need to talk about them in full.

24 The next thing on our agenda, right, Mr. Heath,
25 is the report from the ISO?

1 EXECUTIVE DIRECTOR HEATH: That's correct,
2 Mr. Chairman. We have a series of reports beginning with
3 the ISO followed by the Power Exchange. And I think we're
4 ready for those right now.

5 CHAIRMAN KAHN: Fine.

6 Mr. Winter, would you be kind enough.

7 Mr. Winter, can I -- in continuance of my policy of a
8 deference to our legislative members and guests, Senator
9 Peace has left the floor and would like to make a comment.
10 So could I ask your indulgence, please.

11 Senator Peace, welcome.

12 SENATOR PEACE: Thank you, Mr. Chairman. I
13 appreciate that. I had an opportunity to speak with
14 Ms. Bowman earlier as well as here and with staff with
15 Senator Bird and some others. We also have spent the
16 morning reviewing some of the published documents that --
17 before last night's meeting, I think the most troubling
18 piece of information were publications that correctly
19 predicted what the action of the ISO Board would be.

20 We will be asking for an Auditor General's
21 investigation, a Department of Justice investigation.
22 We're particularly concerned about the actions of some
23 individual board members. There was always a concern in
24 the work product about the use of a stakeholder board.

25 I spent some time -- and I wasn't there during

1 the deliberations after the public -- what was called
2 public presentation, which was pretty hilarious. I guess
3 it would be hilarious if the consequences weren't so
4 severe.

5 But it was personally embarrassing because,
6 obviously, I played a hand in putting this work product
7 together. And I wasn't disturbed so much by the action,
8 in fact, I left before the action was taken, but I was
9 disturbed by the horrendous circumstances in which the
10 decisions are made.

11 It's clear that we have allowed for the
12 development of a little cabal of insiders. The
13 information presented, there were probably -- I don't know
14 the exact numbers but I would guess there were maybe 15 or
15 16 presenters. They were essentially all generators. Not
16 a soul stood up and made a public presentation, or a
17 comment from the consumer's perspective.

18 The reaction of the folks on the board itself was
19 more a debate between what big company was going to
20 benefit if we did this versus what big company was going
21 to benefit if we did that. It was all about shoving money
22 back and forth between the suppliers.

23 It was -- and for those that were involved in the
24 debate of the Legislature, that was precisely what got
25 this Legislature involved in the first place. We tried to

1 rescue what was a juggernaut developing inside the Public
2 Utilities Commission to a work product.

3 And there was certain things that obviously were
4 compromised. It was a different environment. We had a
5 republican assembly and a democratic senate and a
6 republican governor. The Governor supported it rather
7 strongly. One of the fundamental elements of the
8 compromise was to the stakeholder board.

9 What I saw last night, again without reference to
10 the decision, what I saw in terms of the quality, or the
11 lack of quality of the deliberation, the quality or lack
12 of quality of the breathe of information that was put
13 before them, was so much worse than anything I could have
14 possibly imagined in my worse nightmare.

15 And when you couple it with the fact that there
16 was a published prediction of the result, it's clear that
17 proceedings had already occurred privately and a decision
18 had already been made.

19 That's about the biggest problem we could
20 possibly have. Because you know we can argue and disagree
21 about what the right decisions are to make, but these
22 deliberations are indefensible. I'm particularly
23 concerned by the conduct of the chair. It's -- you have
24 to at the end of the day hold the person who's in charge
25 of running the show responsible. And I would hope that

1 this body would act to whatever degree of powers that
2 they're afforded with as this element evolves.

3 I have no doubt that the Legislature is going to
4 act to change the -- and I don't know exactly what -- what
5 we're doing is looking at our options. These are public
6 corporations created by statute. They can be uncreated as
7 fast as they were created. And it may be the cleanest
8 thing to do is to just abolish them and start over.

9 One of the options is to take the operation of
10 the ISO and PX and consolidate their governments under the
11 Energy Commission. Other options are to look at some of
12 the other board elements that we have decided before. And
13 it seems to me either we do that and -- and let me step
14 back a minute.

15 I don't want the impression to be that some of
16 these things are just because of actions of the ISO.
17 There are some actions in the PUC that's part of the
18 configurations that have contributed to a lot of
19 dysfunction going all the way back to sending the signals,
20 that in my view, forced the utilities to sell too much of
21 their power plant capacity.

22 None of us in the Legislature envisioned the PUC
23 was going to basically run all the power plants out of the
24 state from an ownership perspective. And a lot of the
25 reason why you have the folks in that room getting

1 snookered -- and that's what happened. What happened
2 meaning you either have people who are voting
3 self-interest, because of their relationships with
4 generators making huge profits; or you have people who
5 that are just getting buffaloed.

6 Let me say, it was interesting watching the quite
7 particulate presenters, and it's all in respect, but they
8 have an economic interest and they make their presentation
9 and they bring their graphs in. And they make this bogus
10 argument that if you move the cap down to 250 that the
11 lights are going to go out.

12 Now, we had similar presentations, you know, this
13 total scare tactic kind of methodology before, but the
14 bottom line is: California in the west is a price setter.
15 The reason why you get \$800 prices in the Northwest in the
16 last couple of days is -- does the number \$800 ring to
17 some relationship to anybody?

18 It's because there's \$750 price caps in
19 California. And so if somebody in the Northwest is trying
20 to get power, they have got to outbid California's price
21 cap in order to keep any power in the Northwest.

22 Now, there's also an unfortunate thing happening
23 in respect I think specifically with the consumer groups.
24 First of all, the large consumer groups, most of the
25 representatives are clearly conflicted, because they

1 basically are representing oil companies that are sellers.
2 Secondly, they are typically direct-access participants
3 who are affected differently.

4 Small consumer groups and their conduct really
5 concern me, because they seem to be falling in love with
6 the idea that high prices are a good thing. First,
7 they're getting buffaloed into this idea that, you know,
8 the sky is falling, the lights are going out.

9 Then they're conflicted by another view that,
10 well, we're in this world of competition, what we really
11 need is higher prices because you know people need to
12 conserve more, and they won't start conserving until we
13 get the prices as high as we can.

14 Well, when you look at the average household and
15 what the overall cost of their electric bill is relevant
16 to what the other expenses in the house are, you're not
17 going to get the kind of conservation reaction under any
18 circumstances that you really would like to get in an
19 ideal circumstance. And you're certainly not going to get
20 it until you get real-time meters in the people's homes.

21 To an extent, it will always be a relatively
22 small subset of the residential population that reacts to
23 these price signals, because a high proportion are going
24 to be relatively indifferent. It's not of a large enough
25 component of the household bill.

1 And what I see happening in the consumer group
2 environment is people are evaluating the world as though
3 the only economic decision a person has to make in their
4 life is whether they keep the air-conditioner on or not on
5 Thursday afternoon. People are dealing with a whole lot
6 of other things, tuition, food, telephone bills that are
7 bigger than their electric bills, cellular bills for
8 phones that don't even work, and a variety of other
9 things.

10 All of this argues -- and I frankly didn't have a
11 lot of -- you know, my hope in terms of yesterday's vote
12 was ironically placed in the generators. And let me tell
13 you why. I expected and hoped that the generators would
14 be smart enough because they know what they're doing, they
15 know what the situation really is.

16 And I laid my hope in the notion that they would
17 have a self-interest in recognizing that this is an infant
18 market. And that it was in their long-term economic
19 interest to make sure it survived. In the end, the greed
20 won and they couldn't resist the temptation of the moment.

21 Mr. Brulte and I had sent a letter to the
22 Governor two weeks ago calling for -- or suggesting that
23 the Governor ask the Legislature for the Governor's
24 emergency powers to expedite the construction of the power
25 plants. There's really only two ways to go about that.

1 One is to kind of breakdown the barriers for
2 construction in areas we know we need to get power plants.
3 And part of that is having discussions with leaders of
4 large companies, for example, like Cisco who are busy with
5 opposing new construction of a power plant in San Jose,
6 which is a real great corporate citizen position to have
7 in the community, being one of the areas that's most
8 significantly impacted by potential shortages.

9 And here you have a corporate leader with the
10 kind of sophistication of Cisco and ironically at the core
11 of the business that's driven -- you know there's no big
12 reason why we have a shortfall of supply right now in
13 computers. Basically that's what this issue is about,
14 it's about refrigerating computers. And here you have
15 Cisco who is clearly part of the problem leading the
16 nimbism in the world to prevent the construction of a
17 power plant. Very troubling.

18 But the second way to do it, and it may be the
19 way we're going to have to do it, is to command and
20 control. It may be that we are just -- we have been
21 pushed by FERC too far, too fast. And that California has
22 to take the kinds of actions that states like Texas have
23 taken and we need to go back. And in order to get an
24 adequate amount of in-state supply, so we're not dependent
25 on out-of-state supply, we may need to go ahead and build

1 these power plants under our own command and control
2 regiment, regulate them.

3 And that may also mean taking back, under
4 regulatory authority, the operation of in particular
5 certain PT plants around the State that we rely upon. A
6 lot of these companies spent huge amounts of money on
7 these power plants. And California ratepayers were
8 beneficiaries of that in getting the stranded costs up for
9 that.

10 What they're doing right now is using the threat
11 of blackouts to try and recover that investment. And they
12 got fancy charts and demand curves that can show you what
13 happens in the theory. I mean it's just like going back
14 to college and taking freshman Econ-101 all over again.

15 The problem is the folks in the room making the
16 decision at the ISO are either part of the economic
17 equation of a self-interest in perpetuating that
18 simplistic Econ-1 presentation in a concerted and very
19 cleaver effort to protect their profiteering; or in the
20 alternative, some of the other members quite frankly
21 obviously never got beyond Econ-1 and really thought that
22 competition was just about supply and demand. And so
23 they're actually buying this crap.

24 This market is not as broken as the deplorable
25 governance discussion I witnessed last night. In fact, it

1 was so bad I had to get up and leave. And I don't think
2 the folks who saw me get up and leave and came out and
3 talked to me understood why I was leaving.

4 You know those of you that I've had the honor and
5 privilege to work with, for whatever reason, I've always
6 been a person who's more interested in the process than
7 winning the outcome. One of the reasons why I think I've
8 been able to do a halfway decent job in terms of helping
9 this institution, meaning the Legislative institution
10 getting a budget on time is I paid less attention on what
11 the fight is over that other people are fighting about in
12 terms of how much money goes to this and how much money
13 goes to that and I have tried to stay focused on being an
14 administrator and keeping us on track.

15 What I saw last night was so personally
16 offensive, that as a citizen in the context of its
17 deliberations operations that I'll resign from this
18 Legislature before I fail to change them.

19 Thank you.

20 CHAIRMAN KAHN: I suggest we take a 10-minute recess
21 and then ask the ISO to regather themselves. Thank you
22 very much.

23 (Recess taken from 10:56 a.m. to 11:10 a.m.)

24 CHAIRMAN KAHN: We are on item Number 5 of the
25 agenda, the ISO and Power Exchange reports.

1 Mr. Winter, thank you very much for deferring.

2 And, Mr. Robinson, welcome.

3 Mr. Winter, the floor is yours.

4 MR. WINTER: Needless to say, the discussion that
5 proceeded this was most fascinating. I guess I'm the
6 reliability person. I am the ISO. We're the ones that
7 try to keep the lights on here.

8 What I would like to do and look to your
9 guidance, I can walk you through what happened on June
10 14th and give you a very quick synopsis of what transpired
11 and what really was occurring. Then, I do feel compelled
12 to make some comments about the meeting last night.

13 I would prefer to do those after the presentation
14 on some factual things of what transpired and why we
15 dropped load. And if that would be your pleasure, if you
16 could let me know how much time you would like me to
17 contain my remarks to, I'll try to either speed up or go
18 more slowly.

19 CHAIRMAN KAHN: I think we would like you to take as
20 much time as you need. And I think you ought to take
21 advantage of the opportunity here, you do have Senator
22 Bowman and President Lynch. And as you know the Governor
23 has asked us to do an investigation.

24 And so anything you can tell us about the events
25 and your views as to things to fix it would be very

1 helpful. So take your time.

2 MR. WINTER: First, I would like to layout for you
3 that there really were three very distinct things going on
4 at the time that we got into the load situation in the Bay
5 Area.

6 And the first one of those was an operational
7 constraint, which I will take you through first. The
8 second is the communications and what happened along the
9 communications lines. And the third were the market
10 issues that arrived on that day.

11 It is very easy to try to connect all three of
12 those together, but in reality they're very disconnected
13 and, yet, interrelated. So what I would like to start out
14 with is tell you the operation and what transpired during
15 that time frame.

16 If you will look at the first page in my handout,
17 in transmission planning what you try to do is you
18 identify your load area and then you try to build a system
19 around that load area that gives you either duplicate or
20 triplet feeds into all of the things so the loss of any
21 component, be it generation or transmission, does not
22 force you into the position of having to take an outage.

23 The second thing that you're very concerned about
24 is not only the immediate area, but the entire impact on
25 the rest of the system. Those of you that were here, and

1 I think you all were on August 10th, 1996, when a tree got
2 into a 500 kV line and that tripping took out the whole
3 Western United States, less known to people was that that
4 very same situation happened on July 3rd and July 2nd that
5 year with a tree in another location.

6 So the reason I bring those up is the system is
7 very dependent and interconnected through the Western
8 United States. So as the ISO operator I am not only very,
9 very concerned about any particular small area, but I'm
10 also concerned about what impact that might have on the
11 whole system should we get into trouble.

12 And so as you look at this smaller area of just
13 the Bay Area, let me say that we had sufficient resources
14 in the state to cover the loads for those days. Now, when
15 I talk about the markets, you'll see how we got those, but
16 nevertheless there were sufficient resources.

17 What we did have was outages in the -- inside
18 this east Bay Area that limited our ability to import. In
19 other words, if you have generators on, we have what we
20 call voltage stability. And you need the rotating
21 machines to, in fact, keep the voltage up or you get into
22 what you call voltage collapse. So even though we had
23 voltage outside the area, there was no way to get it in
24 with the load.

25 We began looking at this problem Sunday night and

1 the incident occurred I believe on Wednesday. And if
2 every machine is on in the Bay Area and all transmission
3 lines are available, we can input about 9100, 9150
4 megawatts into that area. We were projecting a
5 temperature in San Francisco of about 95 to 96.

6 At those temperatures we were anticipating around
7 9,050, or 9,100 in load. That meant that if all the
8 machines were on and everything was working and all the
9 transformers were available, that we could serve 9100
10 megawatts.

11 At that time, as we approached Wednesday, we
12 found that we were actually 879 megawatts short of
13 generation in the area. Now, that is not correlated
14 directly. You can't just take the 9100 capability, take
15 879 from it and get to the answer that you can only serve
16 8200 megawatts, because you have the support of
17 transformers around it, the other outside lines, and
18 redundancy.

19 So as we ran our studies on Monday and Tuesday it
20 became very clear to us that we would only be able to
21 serve about 8600 megawatts, projected load of 9100-plus.
22 So that left us between 5- and 600 megawatts short. We
23 had interruptibles, which are the people who have
24 willingly agreed to drop off the line, magnitudes of
25 between 2 and 500 megawatts. Again, in the 500-megawatt

1 range, those were outside the immediate Bay Area, but had
2 some impact.

3 And so as we moved into the day we started doing
4 a couple of things. And if you will look at the next
5 graph, which is this big wiggly line, that is the voltage
6 that we have on the system. And when we move into an area
7 which is limited by voltage stability rather than import
8 capability, there's a few things we can do and do do.

9 So if you'll look at 6:00 in the morning you'll
10 see that we were at 235 kilovolts. Our critical point is
11 226, at the bottom. As we moved into the morning hours we
12 recognized that we were going to have to add sufficient
13 voltage support to hold the voltage up.

14 So we contacted PG&E, they made certain that all
15 of their static capacitors were in place and we kicked the
16 voltage up to around 235. As the load began to grow at
17 around 9:00 on that graph, you'll see that it begins to
18 drop dramatically. And this is as the load continued it
19 dropped and it dropped.

20 Then you'll notice that around 10:00, 10:30 time
21 frame that it starts to level out. And what we did there
22 was we called on all the generators and told them to start
23 putting out maximum VARS, which is a term to -- it's the
24 electrical term that gives us voltage support. It's also
25 the time when the municipalities started running their

1 units to give us maximum support.

2 That held us. As each of those units came on,
3 you can see the voltage recover. Then we started about
4 noon time. And if you'll look at the next graph this is
5 merely an expansion of the time between 12:00 and 3:00.
6 It's the same curve. We were headed down. We were at
7 2:30. Then right about 12:00 o'clock the load just
8 started continuing.

9 This is when we were getting reports of
10 temperatures were going to be in the 103, 102 range with
11 an overall area of 107 for the Bay Area.

12 We started down that rather quickly. And at 230,
13 less 229.5 we activated the interruptible load. When we
14 activated that, normally what we get when we drop to the
15 500 megawatts is we get an immediate rise back in that
16 voltage. And then this gives us time to analyze, you
17 know, where the load is going and what is the volunteer
18 load that's dropping off.

19 You can see that dropping 500 only bought us
20 about 10 to 15 minutes. And then we were right back on
21 the tremendous slide going down. We watched that over the
22 next 15 minutes and then when we reached the 227.6 headed
23 for 227 we said, "This is continuing. It's early in the
24 day. And we're going to either, one, if we don't drop
25 load, we're going to risk the whole Bay Area. And even

1 worse, we could cause an instability in the whole Western
2 United States."

3 So we, the ISO, made the decision then to drop
4 100 megawatts. Now the interesting thing here is that
5 when we dropped that 100 megawatts, the load was still
6 rising dramatically. But the very fact that we dropped
7 that and the news media went out immediately with the fact
8 that we had done that, we got a tremendous amount of
9 volunteer people running around turning off their lights,
10 turning off their air-conditioner.

11 So even though we took 100 megawatts, that action
12 was supported by a lot of different people individually
13 and the load tapered off. And we recovered back to 228.
14 Now, remember we're still walking with one volt here.

15 SENATOR BOWEN: How much load was actually dropped?

16 MR. WINTER: I believe it was about 130 megawatts.
17 And, you know, that is fascinating for a couple of
18 reasons. And as I talk about communications, I'll go into
19 that.

20 If you'll now drop back to your first graph,
21 where you see right at the 12:00 o'clock period, you can
22 see we dropped the 100 megawatts. We came back up to 228
23 and we held that for one hour, because our rolling
24 blackout program is that you take people off for an hour,
25 then you go to another block and you take them off.

1 Now, the reason that it jumped back up is I
2 couldn't take off 100 megawatts and then take another 100
3 off. I had to take off both at the same time and then
4 start bringing them back. So, in fact, for a few minutes
5 there we had 200 off. That's when the voltage went up to
6 229.5. Then as we brought back the 100 it dropped down.
7 Then the next hour, we rotate again. And we had to bring
8 that up. We did that for three hours.

9 At the end of the three hours we were moving past
10 the 4 to 5:00 o'clock time frame and we were willing then
11 to say, "Okay, let's bring back the firm load." We
12 brought back the firm load and put it back on line. We
13 did not bring back our interruptibles.

14 But we around 6:00 -- I'm sorry, that would be
15 15, at around 5:30 we went ahead and started bringing back
16 the interruptibles. And we, again, were heading down and
17 even actually got to 227 watts -- or volts. But the key
18 point there was we were in the time of the day when the
19 load was starting to drop off.

20 So at that point in time we said, okay, we can
21 risk getting close. The load is not growing. And as the
22 load then came off that evening, you can see we restored
23 our voltage.

24 Now the next day, June 15th, during all of this
25 time that -- as a matter of fact, that evening, we lost

1 another generating unit in the Bay Area, 680 megawatts.
2 They had a fire in their auxiliary area. And we called
3 them and said, "Don't take your unit off," because they
4 were able to operate it at a reduced rate. So we held
5 them on at 200 megawatts.

6 One of the interesting things, we have been
7 practicing this very scenario for a couple of days as part
8 of our summer preparation. We run the operators through
9 different emergency situations. This one we had run
10 through.

11 And I didn't realize it until we were doing it,
12 after the fact, but when we did that scenario, PG&E had
13 before 1,000 blocks. In other words, if we shed load,
14 they would shed them at a thousand. Because of the
15 voltage and the studies we had done, they decided to cut
16 those blocks to 100-megawatt blocks. And as it turned out
17 that was very fortunate and a good thing that came out,
18 because instead of dropping a thousand, we only dropped
19 100.

20 The next day, we were faced with the same
21 situation. They were indicating to us that the
22 temperature was going to drop from 103 to 99, the fog and
23 the winds were stalled out over the ocean and not coming
24 in. With the loss of Potrero VII, or the reduced
25 capability of that unit, we were then looking at a peak of

1 8400 is all that we could serve.

2 We rode that roller coaster in the morning. It
3 came up, the load. It was going to be hot. We were
4 racing right into a similar situation. And then Mother
5 Nature was a tremendous help to us. The fog came in and
6 the temperature actually dropped almost 30 degrees in San
7 Francisco.

8 When that happened, very clearly, the problem
9 immediately evaporated in the Bay Area. And we breathed a
10 little bit of a sigh of relief. The loads did not drop
11 off as nearly as we thought, but they didn't grow. So we
12 were able to handle them.

13 At about 12:00 o'clock that day we recognized, or
14 were aware of another problem. And that was in Sacramento
15 the temperature had not dropped. As a matter of fact, we
16 were heading up extremely warm again.

17 And on that first graph you'll notice that there
18 is some transformers there into the Bay Area called Tesla
19 and Tracy. And those transformers serve not only the Bay
20 Area, but they also serve the Sacramento area.

21 So we suddenly found ourself in a position where
22 we were exceeding the capacity of the transformers at
23 Tesla and Tracy. And the next graph shows that we went
24 over their rating capability. And at that time we
25 activated SMUD's air-conditioning load. So you know all

1 these things as we're moving from one spot to another, we
2 were running into them.

3 Before you go to the next graphs, I would like to
4 talk about the communications a little bit. We initiated
5 in the May time frame what we called "Power Watch 2000."
6 And the whole purpose of that was to begin to condition
7 people to the fact that we were going to have some real
8 scarcity in the state. And so we were very concerned that
9 people be aware and actually do the voluntary curtailment.

10 And I think that has been extremely successful.
11 In the discussions with the news media, which is really
12 our communications to getting people on to voluntary
13 shedding, the investor owned utilities, the
14 municipalities, everybody worked very, very hard during
15 that time frame to have their communications out.

16 I have, unfortunately, been involved in a few of
17 these in my life. And I have to say the way in the which
18 the operators executed this was probably the best that I
19 have ever seen. They did it efficiently. They did it
20 quickly. Everybody in the operating arena knew what was
21 going on.

22 The news media I thought responded quite
23 accurately. They were very quick to identify the
24 temperature and the constraints. And I think that
25 communication went well.

1 I think that some of the places the
2 communications didn't go real well was probably -- and I
3 take full blame for this -- myself with Michael and
4 Loretta, I didn't communicate with them as quickly as I
5 should have. I make no excuses for that other than as we
6 were going through our drills, I should have included
7 myself and the two of you in the drill so that we would
8 have that communication link opened.

9 I think we rely on E-mails a lot. We also have
10 two people that spend their full time trying to notify
11 everyone. But I would take you to the time frame, yes, we
12 knew we were getting into trouble, but quite honestly
13 every day we approach the morning getting ready to get
14 into trouble.

15 And the question is: How far is it going to go?
16 And that curve got bad. And then within 30 minutes we
17 moved from what was, oh, just drop a little bit of the
18 interruptibles to, we're going to have to drop firm load.
19 And that was a tremendous decision and people were having
20 to make that in about 30 minutes. So I think the
21 operation went well. I think the communication at the
22 lower level went well. I think I failed in keeping you
23 all informed.

24 Now, let's talk about markets a little bit,
25 because while they're a totally separate issue for this

1 particular problem, we do have some underlying concerns.
2 If you look at the next curve, and I hope I gave you
3 colored copies, I'm not sure that I did. But if you look
4 at the green line over this period of time, which runs
5 from June 12th to June 18th, you will see the green line
6 which represents an actual load that we saw that day.

7 So you can see that we were looking at 43,000
8 megawatts. Now, also recognize that if I took off 5, 600
9 that really would have been 44 plus, because we, in fact,
10 did interrupt firm load. You'll also notice that at the
11 blue line, which is the day ahead schedule -- now
12 understand that our market is set up for people the day
13 ahead to bid in their load.

14 And they have a choice. They can choose to bid
15 in to that market, or they can choose to work in the hour
16 ahead market, or they can choose to be in real time. Now,
17 when the ISO was set up it was envisioned that people
18 would put the majority of their load into the day ahead
19 schedule.

20 And that the ISO, then, would be the back drop,
21 if you will, supplier of last resort and we would make up
22 any minor differences caused by weather fluctuations
23 and/or people's units breaking and we carry reserves for
24 that. And so we were planning on looking at that load.

25 But when we get into this situation, you can see

1 that the day ahead load was bid in at 31,000. I am now
2 faced with a 43,000 peak load. And I have got to decide
3 on how much I can rely on people being there. And markets
4 being what markets are, people will, in fact, not always
5 let me know exactly what's available out there.

6 But going into that morning, I've got to make a
7 decision of how much I will quote, either go out of
8 market, or buy to make sure that I can cover the peak
9 hours. Now, operators aren't historically large risk
10 takers. And so we try to be a little bit conservative,
11 but we also have some things that help us.

12 Number one, I know what each of the units in the
13 state is capable of. And, therefore, I can pretty much
14 determine, "Okay, it's there. I don't know what price
15 I'll have to pay for it, but it's there. So I won't worry
16 about it."

17 The dilemma that California has is that we are a
18 major importer of power. In peaks of 1999 we were
19 importing more than 10,000 megawatts to the State of
20 California. As late as yesterday, at 7:00 o'clock in the
21 morning, the schedule showed a net import to the state of
22 258 megawatts. That is a huge risk for me to be taking.

23 And so I sometimes will go out of market, which
24 happened on May the 22nd or 23rd, I can't remember now,
25 and buy power in that market. When I do that the market

1 goes absolutely crazy. Just as Senator Peace said people
2 chase our price. So they know I have a 750 cap and I go
3 out in that market the immediate reaction in the whole
4 Western United States is to bring that bid price to \$750.

5 Now, if you're sitting in the northwest, or if
6 you're sitting in Arizona, if you need the power you're
7 going to bid a dollar higher. If you don't need the
8 power, then my price wins and I get the power in. It's an
9 area of concern. People say that we set the price, that
10 we can drop it to 100, we could drop it to 250 and,
11 therefore, the market would follow.

12 I don't know that I exactly prescribe to that.
13 We have seen behavior -- but on the other hand, I think
14 that by dropping it, we will follow. And so when I get
15 into the board action, I'll go into that more.

16 But along with this need, we have a portion of
17 the market that we call, "Replacement Reserve." And
18 replacement reserve was developed to cover two
19 contingencies. The first contingency was that we wanted a
20 market that large units, large coal-fire units which
21 cannot move real quickly, could join, because in our
22 ancillary service markets one of the requirements is that
23 the unit has to respond within ten minutes.

24 And so by developing this replacement reserve, we
25 could take coal units that move much, much slower in

1 increasing their load and get them into the market. And,
2 therefore, add depth to the market and reduce the cost.

3 The second thing that we went after was this very
4 issue of people scheduling, because the next graph -- I'll
5 show you very quickly why they do this. And it's
6 certainly a legitimate strategy to reduce costs. But we
7 wanted to figure a way that we would send the message that
8 if you under-scheduled dramatic amounts, recognize that
9 I'm going to have to go buy it. And, undoubtedly, I'm
10 going to have to pay 750 to do it.

11 So May 22nd we went out of market, tried to
12 buy-out of state, that created a whole havoc in the
13 market. On June 14th we bought in the replacement reserve
14 market. And you'll see what that did to the prices.
15 Okay. Quickly, I think there's a couple of things --

16 MEMBER WILLISON: One question.

17 MR. WINTER: Sure.

18 MEMBER WILLISON: When you go out of state to make
19 that purchase, are you doing it the day ahead, or can you
20 do it an hour ahead where you could drive the price --

21 MR. WINTER: All of the above. Most of the time we
22 will not go out of market until, say, 8, 9, 10:00 o'clock
23 in the morning with the idea that most of these peaks hit
24 around 2:00 to 5:00 in the afternoon.

25 MEMBER WILLISON: So if you don't fill your load

1 there, somebody who's holding back the capacity could come
2 in and give you a lower bid than 750?

3 MR. WINTER: Right. One of the very interesting
4 things that happened on May 22nd, which caused quite a
5 furor in the marketplace was at 9:00 o'clock I had to buy
6 four or five hours in the afternoon to cover my peak. So
7 I paid 750 for it.

8 Well, then, suddenly in what we call our
9 real-time market price people bid in and I didn't need all
10 of that, because I had covered some of it. And it
11 actually cleared at \$353. So then everyone said, well,
12 you know you bought outside, and here we're only getting
13 353, why don't we get the full 750? So timing, you know,
14 made that happen.

15 That was another reason that we went to the
16 replacement reserve, because we tie that up the day of and
17 early in the morning and just go to the market and say,
18 okay, I need 3,000 of this 13,000 deficiency to -- as
19 someone said, my peace of mind. But I'm here to tell you,
20 for your piece of mind, because otherwise we don't serve
21 the power.

22 And so if you look at the dollars, there is a
23 couple of things. You can see replacement reserve when
24 you're paying \$750 a megawatt hour for anywhere from 10-
25 to 13,000. That number got up to \$34, \$44, and \$41

1 million in one day. This is a lot of dollars.

2 The secondary impact of that, which is if you
3 look across you'll see all the other ancillary services
4 also rise, is that as people bid into the replacement
5 reserve that makes my other markets more scarce and,
6 hence, I go higher up the demand curve. And I have to pay
7 higher prices all the way across. So clearly those days
8 were horrendous numbers.

9 But I want to talk about two things. Next to
10 just take you to this --

11 SENATOR BOWEN: Before we leave, if I might.

12 MR. WINTER: You bet.

13 SENATOR BOWEN: What does this chart suggest to you
14 about whether the market is structured in a way that is
15 workable in the long-term?

16 MR. WINTER: Let me talk -- there's another graph
17 that I want to talk about at the end that will get to that
18 very question.

19 SENATOR BOWEN: Let me, then, go to this chart and
20 just ask you to give us a little idea of what's happening
21 this week.

22 MR. WINTER: I wish I could do that, but I didn't
23 bring those numbers with me. I know it's high. I don't
24 know exactly what it is.

25 SENATOR BOWEN: So would it look more like the

1 middle of June than early June?

2 MR. WINTER: Right, unfortunately. Now, let me also
3 point out the next graph I think is interesting. And I'd
4 like you to look at a couple of things here. Number one,
5 is if you look over '98 through June, you will see -- go
6 to total cost, which is the ancillary services plus the
7 energy market, which is the purchases that people make
8 ahead.

9 You will notice that in August of '98 we also had
10 a \$1.1 billion month. In October of 1999 you will
11 recognize that we had a \$1 billion month. May in this
12 year I think you will remember was quite warm, we had
13 another \$1 million month. And I'm guessing that June is
14 going to be probably above the \$2 billion range.

15 An interesting thing that I would bring to your
16 attention is that look at the percentage of ancillary
17 costs versus the total energy costs. You will notice that
18 in the beginning we were running at 10, 29, 21, 14 percent
19 of the total cost. At that time we recognized that was
20 high. And so we started taking some corrective action.

21 We did some modifications to the tariff. We put
22 in some software to track these. And we were shoving that
23 percentage of total energy cost down into the 3.1 percent.

24 Now, in June that jumped to 14.8 again. And
25 again the numbers are big, but also recognize that the

1 ancillary service, or the reserves that we bought still
2 were only 14 percent, 15 percent of the total energy
3 costs.

4 Now, why would people not bid in the hour ahead?
5 And what I'd like to do here -- and there were some graphs
6 last night that I'm sure Senator Bowen couldn't see over
7 the phone, but they went over this in detail. And I'll
8 try to do it real quickly. And I will talk as if it is
9 the whole market.

10 If you look at the price of energy, and let's
11 just say for a number it's \$300. And that \$300 limit is
12 hit at 30,000 megawatts. If you take -- and I haven't
13 checked my numbers, but I think you'll get the idea -- if
14 you take \$30,000 times 300 and then you add to that the
15 remaining 13,000 megawatts and figure that to hit the cap
16 at 750, if you total that day-ahead commitment at 300 plus
17 the additional real-time power, you'll come up with a
18 number.

19 And by moving how much you bid in the market, you
20 can make your total price vary what you pay for the
21 energy. So as long as you know that the PX price is real
22 high, you will bid less into that market recognizing that
23 even though you have to pay 750 for the remaining portion,
24 the total of those two is less than if you bid in the full
25 43,000 at \$500.

1 So people are behaving exactly like they should
2 to reduce the cost. There is another piece to this. If
3 you look at that equation you can say, they can buy in the
4 day ahead, and that's in the PX price, you can put all
5 your energy in there and maybe pay \$600. Then you could
6 change your bid in the hour ahead, depending on what you
7 see in the pulse, or you can take your risk in the real
8 time.

9 You add to that the ancillary service costs and
10 then you have what I call the defense mechanism for all of
11 this. And that is what we call hedging and that -- the
12 numbers I don't know. So when people run around and say,
13 my goodness, you just cost a billion dollars to the
14 market. I don't know whether that's true or not, because
15 if, in fact, someone was hedged, the total cost may be
16 something much, much less. Now, if people didn't hedge
17 then I think we have to wonder why.

18 And in this market structure -- remember how we
19 used to do it in the old days? In the old days we built a
20 power plant in the investor-owned utility and we made that
21 our base load. And we said, okay, we would go to our
22 friendly regulator and they would say, all right, you
23 spent \$4 billion on a plant, here's what you get in return
24 and that is the cost.

25 Then we would look at it, and some companies more

1 or less would say, I'm going to do some long-term
2 contracts, because I don't know that I have enough
3 generation in state, I'm going to go to Arizona and make a
4 deal to buy another 2,000 megawatts there. And then in
5 the very end we could do a couple things.

6 We could either put in peaking units, which would
7 pick up just these few hours of peaking, or, in fact, we
8 would make contracts for that peaking. So as we move to
9 the new market, what we did was we took all of this fixed,
10 guaranteed price that everybody paid all year long for the
11 units, and we moved it into the marketplace.

12 And we did it with absolutely no hedging for
13 those people, if you will, because they didn't know if
14 they were going to get that unit paid for by running it 4
15 hours, or 500, or 5,000. And so we knew that we would
16 have a very volatile risk situation.

17 And recognizing that, then, we said, okay, we
18 have to give people the mechanism that they can hedge.
19 And so people have the ability to buy forward. You could
20 still buy a year in advance, you know, and the PX has set
21 up markets to let people do that.

22 So when I look at these big numbers and people
23 come to me and say the world is near an end, I would be
24 the first to say that these are very, very large numbers.
25 They have me very, very concerned and is why I supported

1 some kind of price cap, be it wherever it may be. It was
2 very important that as we do this transition, as people
3 move into that financial world that is completely separate
4 from the ISO and its operation, that people could hedge,
5 encourage generation to come, allow the stock price,
6 unhedged, to be a real signal of what the scarcity is and
7 encourage people to come to the state.

8 And as you look at those and as you see the
9 Board's resolution, one of the things we're very
10 interested in from just an overall standpoint is how much
11 hedging was going on and what were their capabilities to
12 hedge.

13 So that's kind of what has happened in those
14 days. I guess now I would like to get to the Board
15 action.

16 SENATOR BOWEN: May I? The concern here is: Who is
17 it that we're asking to bear the risk of someone who's not
18 being sufficiently hedged?

19 MR. WINTER: I think that's a very good question,
20 because --

21 SENATOR BOWEN: No, I'll take it back and ask a bad
22 question.

23 MR. WINTER: Okay. Actually, I was looking for some
24 time to come up with an answer. Clearly the person that's
25 being asked to take the risk is the customer who is the

1 person who is least knowledgeable, probably unable to
2 handle this.

3 However, at least my understanding, the UDC, or
4 the Utility Distribution Company, who is the
5 representative of that customer is still regulated. And I
6 think how much they risk, or don't risk is really a
7 regulatory decision that has to be made.

8 SENATOR BOWEN: Could you -- I'm not sure I
9 understand.

10 MR. WINTER: Well, unless I have forgotten my days
11 in the investor-owned utility, I used to go through
12 constant prudence review of contracts that I bought, what
13 I paid for power outside the State, how I hedged the load.
14 And those were all reviewed by the PUC and were either
15 allowed or disallowed.

16 So to me you'd be making the same kind of hedges
17 here only you would have a lot more facts which is a
18 market and what the market clearing price was set at.

19 MEMBER WILLISON: And so how do the costs, or the
20 profits from the hedging get shown up in the consumer's
21 rates, or is there a visibility there that can be
22 observed?

23 MR. WINTER: I think there would clearly be the
24 visibility, because whenever I went in for a rate case,
25 what I always did was said, okay, here's the amount of

1 money that I spent for generation, here is the money that
2 I made on those being below the price that I was paying
3 and that showed up as a profit and was cancelled out
4 against any of the bad things that I'd done.

5 SENATOR BOWEN: I think Mr. Willison is talking
6 about the visibility to the customer.

7 MEMBER WILLISON: Well, that's the next question.

8 MR. WINTER: Exactly.

9 SENATOR BOWEN: And I would just say that my comment
10 would be, recently, 60 Minutes got a nuclear physicist and
11 a rocket scientist together to look at people's phone
12 bills to see if they could figure out the charges on the
13 phone bills. And despite the fact that it wasn't rocket
14 science, neither of them could figure it out. The phone
15 bill is a lot easier than figuring out whether somebody is
16 sufficiently hedged and what that means to the price of
17 energy.

18 MR. WINTER: And I understand that dilemma.

19 CHAIRMAN KAHN: Senator Wright.

20 ASSEMBLYMAN WRIGHT: I think what a lot of people
21 would say in this industry what's always fascinating is
22 people create jargon that is kind of an excuse to obscure
23 what's happening.

24 The cost of natural gas hasn't increased
25 significantly. Much of the power that is generated here

1 comes from natural gas. So if the cost of natural gas
2 hasn't gone up a lot and if the cost of the labor hasn't
3 gone up a lot, and if the taxes on the buildings haven't
4 gone up a lot, and if the other fixed costs of the
5 generator haven't gone up a lot, what is it that created
6 the significant increase in the cost of the electrical --
7 maybe you said this before I came.

8 I mean I could understand that if I'm dealing in
9 a commodity market and I say, well, hell, if the price is
10 going for 8 or 900, I get 8 or 900. But I think the
11 consumer needs to understand that if we're playing in a
12 strict commodity market, the disadvantage that we have in
13 power is that we assume from the public policy side that
14 everybody ought to get power.

15 In other markets we don't care if some people get
16 left out. If it costs too much, you can't afford it, you
17 don't get it. But in this market, we make an assumption
18 with the UDC that there is a mandatory duty to serve.
19 Everybody gets it.

20 The Commission attempts to ensure that we spread
21 that out. So I think that one of the things that startles
22 a lot of us is that when the IOU's on the power, they
23 couldn't have raised the rate as much as you did, because
24 Ms. Lynch wouldn't let them.

25 Now, that we let that get away -- I mean, if

1 there were costs that changed, if the price of natural gas
2 climbed pretty steep, well, at that point you'd say, well,
3 you know, 60-some-odd percent of my cost is fuel, and if
4 my fuel increased this amount then I need to raise it that
5 much to cover cost.

6 But the thing that belies most intuition here is
7 that there's no explanation for what changed that, what
8 precipitated the substantial increase in cost.

9 MR. WINTER: Okay. First off, I would disagree with
10 you on one point and that is the figures that I was
11 handed, and I haven't researched them, shows that the
12 natural gas price per million BTU was 210 in 1999 in June.
13 Right now it is 495, which is about a doubling. Now, that
14 doesn't -- and the reason I only mention that is because
15 that is a factor, but that's not all of it. You'll see
16 the prices of electricity on average have gone up four
17 times and that would only explain maybe about 1.3 times.

18 ASSEMBLYMAN WRIGHT: And, in fact, many of these
19 companies have contracts --

20 MR. WINTER: Well --

21 ASSEMBLYMAN WRIGHT: -- but that's okay. You could
22 still say in the commodity market, that even though you
23 bought it and your price didn't increase that much, you've
24 got to replace your fuel so you're buying replacement. I
25 spent many years in the oil business, I understand that.

1 But even taking what you said into account, that still
2 doesn't account for a quadrupling. You said that the
3 commodity price -- and you're only talking about the fuel
4 price, which is only 60 percent of the cost.

5 MR. WINTER: Right.

6 ASSEMBLYMAN WRIGHT: So if you do the math that
7 still wouldn't account for the doubling, because if the
8 fuel price doubled then that would give you about
9 120-percent increase in the cost of the commodity.

10 MR. WINTER: Exactly.

11 ASSEMBLYMAN WRIGHT: You've got four times. So
12 you're greater than doubled. You more than doubled what
13 you should have been. Not you, but --

14 MR. WINTER: That's what I was going to say: I'm
15 sorry, I didn't. But I play in the market and you're
16 absolutely right and that's why I mentioned the point.
17 And so that wouldn't explain the fourfold increase. But I
18 think the thing that is needed and lacking -- they want to
19 give me answers, but I'd rather just kind of give you my
20 feeling.

21 ASSEMBLYMAN WRIGHT: You know, the way it's been
22 around here lately, you should listen to somebody.

23 MR. WINTER: Well-taken. But as you look at how the
24 prices are established -- and this is when we really get
25 into economics and I hate to get there, because I'm not an

1 economist -- but if you assume that people are operating
2 their units at a loss for some period of time, when they
3 get the opportunity to go in and make up some of those
4 losses, which in a market-clearing price scenario is what
5 our market is designed to do, people will come to that
6 time of scarcity and raise their price dramatically to
7 cover their costs for the year.

8 And, you know, as Senator Peace said, we sold
9 literally billions of dollars of plant to outside
10 interests. And those people are now looking to recoup
11 that. Where with the investor-owned utility, we had
12 depreciated that plant down to, you know, I'm familiar
13 with some of them selling four, five times book. We as a
14 state benefited from that.

15 Do not get me wrong, I'm not saying that people
16 are entitled to a billion dollars just because there is a
17 scarce market. But I do think that there's a legitimate
18 argument for prices to spike and go very high. And these
19 generating-peaking units that I talked about very clearly
20 have a very, very high cost to run. And in the utility,
21 it was not unusual for me to say these aren't going to run
22 if I put all my fixed costs in the neighborhood of 3,
23 \$4,000.

24 ASSEMBLYMAN WRIGHT: What you make an argument for
25 in the public policy side is for the State to almost

1 create its own basic portfolio of power where we could
2 control much of that price and then begin to gradually
3 talk about how much we out source in the private market.

4 Where maybe we say 50 percent of the power in
5 California would be regulated power by the utility. And
6 then we would only out-source that portion above 50
7 percent so that we would be able to create a hedge,
8 because if it was a regulated group then we could
9 guarantee a rate of return then that would give us a level
10 price for at least half of the power and we would only be
11 exposed to volatility for that portion that you're
12 describing.

13 And you're creating an argument why you almost
14 want to say, maybe it wasn't the greatest thing to do, to
15 expose us to the level of volatility that we had, because
16 those people want to make the money back that they paid
17 for those plants. And they began doing, not anything
18 that's illegal, but they began doing what business people
19 do which is to say: I want to make as much money as I
20 possibly can.

21 Loretta and I have to make sure that Ms. Smith
22 who lives on 79th and Central is able to buy power that
23 she can afford. And we're obligated to try to get it to
24 her; and the guy who's making a billion dollars, that's
25 really not his problem. So what we're doing is we have

1 different objectives that we face.

2 Debra, Loretta, and I and everybody here is
3 trying to say, "How do we get her power?" This guy is
4 trying to say, "How do I get \$2 billion?" And at some
5 point the motivations and the objectives of the two groups
6 of people clash. And we assumed I think that the market
7 would sometimes handle that, but I mean I'm beginning to
8 worry, perhaps, that it didn't.

9 MR. WINTER: Well, I guess my worries started much
10 earlier, because you know I was the one that put the 250
11 price cap in at the very beginning when we saw the
12 fledgling marketing suddenly go to \$9,999 one day, so I
13 agree with you.

14 On the other hand, the premise upon which we base
15 this is that competition overall would have a lesser cost
16 of providing the generation than if we left it in the
17 regulated arena. And that was driven by what we called
18 our famous BRPU offering where we put power plants out
19 there and suddenly the utilities found that these outside
20 market people were bidding much lower prices than they
21 were able to provide.

22 But I agree with you, there is -- until this
23 market matures and in my opinion until we get the hedging
24 mechanisms that can control these sudden ups and downs and
25 shift that fixed cost so that the generator doesn't feel

1 that he has to go for the billion dollars to cover the one
2 plant, then you're absolutely right. And that's why we
3 have the price caps in that we do today.

4 ASSEMBLYMAN WRIGHT: Even last year, I don't
5 remember where the plant was, but remember the guy that
6 decided that he could make a bigger profit selling the gas
7 than the electric and so he shut the plant down and sold
8 the gas, because he had the long-term contract on the
9 natural gas. And when the price of natural gas
10 substantially exceeded his contract, he didn't want to be
11 in the electric business anymore. He thought, hell, I
12 might as well be in the gas business.

13 I'm just saying once you get into an environment
14 where people are allowed to just make money, then
15 unfortunately, from the public policy side you can't be
16 mad at people because they did exactly what was in their
17 interest.

18 From us, from the public policy side, our
19 question becomes: Does the competitive market in the
20 rock-and-roll arena provide for that poor lady that I was
21 describing who was on a fixed income and if her
22 air-conditioner doesn't work then she dies?

23 I mean because at that point all of us look
24 pretty silly when we have to explain to someone that the
25 reason that your momma died is because the guy over there

1 made a billion dollars on his power and he didn't care
2 whether your momma died.

3 I mean it's a different dynamic that we're faced
4 with. He doesn't bear any liability in that regard, but,
5 you know, if you have to go out and face Mrs. Jones as one
6 of your constituents, as I do, it's very difficult to
7 explain then why did you let us into this in the first
8 place, why did you expose us?

9 CHAIRMAN KAHN: Mr. Winter, perhaps, you can segue
10 into telling us what you did last night, address some of
11 the issues that Assemblyman Wright has raised in that
12 context.

13 MR. WINTER: Okay. I'm reporting on so many things
14 today, I'm not sure which stack I'm in. First, let me
15 just make one real quick comment and that is if the
16 individual was, in fact, not generating electricity
17 because he could make more money on the natural gas, we
18 might think about maybe the price of electricity isn't
19 high enough to encourage that.

20 But I don't know how he got to his natural gas
21 price. And I don't want to be argumentative with you, I
22 just -- you know as I think through these things and say
23 you know, "Do we want the market, or don't we want a
24 market?" Then I think there is a transition and it's
25 questionable.

1 Action last night, maybe I watch our board
2 operate too much. I have to say I also watch the
3 Legislature operate once in a while, also. And while
4 there is a lot of discussion that goes on and a lot of
5 people have talked about different things, I guess I do
6 not share the opinion that people came in with
7 preconceived ideas.

8 I spent a lot of very sleepless nights trying to
9 figure out what the right answer was. And I came up with
10 some things that I discussed with the Board ahead of time.

11 CHAIRMAN KAHN: Tell us if ISO management had a
12 recommendation.

13 MR. WINTER: No. We did not take a recommendation,
14 we laid out alternatives. But in the end, I suggested
15 some things that they have put in the motion that I think
16 are very, very beneficial. And let me just read what it
17 was and explain each one of these and why we did them.

18 First off, we asked our Department of Market
19 Analysis and the MSC to investigate the contributing
20 factors to a lack of a workable competitive market, and
21 identify the changes in the market, rules, and operations
22 which would lead, hopefully, to the elimination of price
23 caps. Now, that means we have to answer all of
24 Assemblyman Wright's concerns and Senator Bowen's
25 concerns.

1 Secondly, temporarily reduce the cap in the ISO
2 real-time ancillary service market from 750 to 500,
3 effective July 1st through October 15th. And then these
4 are some things that I asked to be added, because I
5 thought that they would help control the price:

6 First, the Board recognizes that this adjustment
7 in the price cap may lead to difficulties in meeting the
8 summer 200 loads. And such difficulties could constitute
9 basis for emergency Board of Governors meeting.

10 What I was trying to do here is, I honestly don't
11 know if I get into a dropping load in California situation
12 and the price is -- let's say the cap was set at 500 and
13 the price outside the State is 525, and my only option is
14 to pay 530, then I violated the rules.

15 I am not going to drop load just because I am
16 unwilling to pay \$530. Now, whether that occurs or not,
17 we will know. But I do have to have the ability to
18 somehow not put the State in jeopardy over a price.
19 Because if I have to drop 3, 4,000 megawatts that would
20 make these prices payable, compared to the economic
21 outfall.

22 MR. ROZSA: Mr. Winters, isn't it true that this
23 particular motion gave you carte blanche in out-of-market
24 purchases so that there were no restrictions on what you
25 could pay for power that you bought out of market?

1 MR. WINTER: I did not read it -- and knowing the
2 feeling of the Board -- it did not give me carte blanche.
3 What it did say is if I reached an emergency that I would
4 convene a group of the Board under the emergency.

5 MR. ROZSA: No. No. No. Temporarily reduce caps
6 in the ISO real-time ancillary service markets, the
7 original motion had these caps applied to out-of-market
8 purchases. That was changed.

9 MR. WINTER: That was taken out --

10 MR. ROZSA: That was taken out to give you the
11 freedom to make out-of-market purchases at any price you
12 needed to in order to be able to acquire power.

13 MR. WINTER: Right. But you also have to understand
14 that I have to answer to the Board on why I needed --

15 MR. ROZSA: Yes, but it gave you the ability to do
16 that; isn't that correct?

17 MR. WINTER: That's correct.

18 MR. ROZSA: So when you say that the price cap
19 wouldn't allow you to get supplies in order to meet the
20 liability needs, isn't that incorrect, since you had the
21 authority to be able to go out-of-market and pay what's
22 necessary?

23 MR. WINTER: Only incorrect in the sense that
24 because of these price caps I may wait my decision way too
25 long. And so there's nothing --

1 MR. ROZSA: There's nothing that causes you to wait
2 your decision on anything. You still have the authority
3 to make the sort of judgments that you need to make at the
4 time.

5 MR. WINTER: That's correct.

6 MR. ROZSA: And you have the ability to go out of
7 market. And so the reason that I'm raising this point is
8 I think this point was made a number of times last night
9 and it was a very specious point, which is that somehow
10 these price caps prevented you from going out and getting
11 whatever you needed in order to ensure reliability. Isn't
12 that correct?

13 MR. WINTER: That's correct.

14 MR. ROZSA: All right. Thank you.

15 MR. WINTER: Okay. Number two was the two summer --
16 or the two summer 200 trial load programs will be exempted
17 from the change in price caps. Now, the reason we did
18 that is we had already signed contracts with those people
19 who have voluntarily agreed to go off if the demand gets
20 high. And we didn't feel that it was appropriate that we
21 suddenly go back to them and say, gee, we told you we
22 would pay this price, but now we're only going to pay some
23 lesser price. So we covered off on that.

24 Also, management shall work with the responsible
25 agencies and the Legislature to streamline and accelerate

1 the construction of power plants and transmission lines
2 and to eliminate constraints to the hedging opportunities.

3 I don't know where that goes. Senator Peace gave
4 a long talk about the work he was doing with the Governor
5 and the UDC. And it looked to me like in this crisis when
6 the State, in fact, does not have enough supply that we
7 all ought to be working towards some common goal and not
8 at odds with each other. So I had them put that in there.

9 Probably the other thing that I want, and I don't
10 know that I'm quite so fatalistic as Senator Peace on the
11 generators, they clearly aren't motivated to want to
12 recover costs as quickly as possible. I believe they are
13 still motivated to want to have a reasonable market that
14 continues. And they're not going to shoot themselves in
15 the foot over long-term markets.

16 Now, whether that's right or not, I don't know,
17 but I certainly will be negotiating with them to see if
18 there aren't some ways in the market that we can control
19 them. One way that I immediately have put in here is that
20 we will begin to reduce our purchase of replacement of
21 reserve.

22 In addition, I'm going to put a cap of \$100 per
23 megawatt hour on the capacity portion. And so while that
24 limits my ability to offer those, it does in almost all
25 times give me the ability to buy replacement reserve,

1 because past market show that I can get it for that.

2 If it had been in effect during these last few
3 months, and again I don't know how much was hedged, but
4 just in the real dollars we're looking at over a
5 billion-dollar savings just by putting that into the plan.
6 So I put that in.

7 And then last, but not least, one of the things
8 that we have seen happening is that because of certain
9 structures of the market, and we were looking into this,
10 generators feel that they need to provide a back up.

11 In other words, if I bid 100 megawatts and sell
12 it to John and the plant fails, then it is my
13 responsibility as the plant owner to go out and buy the
14 replacement energy for him. So if he's paying me \$100 and
15 the market is at 750, he now has exposed himself to a
16 rather sizable penalty if he does not a provide the power.

17 And so what the generators were doing is they
18 were saying, okay, if I've got four plants any one of them
19 may break, so I'll hold out of the market that additional
20 plant. So that if it breaks I can self-provide my
21 ancillary services. Now, by not telling me that they were
22 doing that I at the same time was buying reserve margins
23 to protect the system from that power plant going out.

24 So what we had was themselves protecting their
25 financial interests; the ISO, from a reliability

1 standpoint, protecting its interests and, therefore, we
2 were double counting. So anytime I get above 38,000
3 megawatts, I'm asking the generators to bid into the
4 market all of their capacity so -- and then we will work
5 with them to try to figure out a way so that they don't
6 get exposed to that kind of double liability.

7 SENATOR BOWEN: Wasn't the rule about replacement
8 intended to prevent gaining in the market? They didn't
9 have that rule at the beginning, but if you bid in and
10 your plant went down, you had to pay a penalty, that
11 wasn't there originally, but that was added?

12 MR. WINTER: I don't think so. Replacement reserves
13 have been in there all the time. The way we use them was
14 changed, but clearly they were always there for that
15 problem.

16 SENATOR BOWEN: I'm just wondering if you're really
17 going to solve this problem just by reducing the
18 replacement reserves. The main reason to cause somebody
19 to go out and cover if something happens is to keep people
20 from bidding into the market and then deciding, oh, the
21 price is higher now, so I'm not going to do that.

22 MR. WINTER: Right.

23 SENATOR BOWEN: But if you include mechanicals and
24 fines and various things like that in there, I think you
25 will always see people not wanting to bid in their full

1 amount of generation.

2 MR. WINTER: And you're absolutely right. And
3 that's why we have to look at that penalty in the market
4 and say: Is it self-defeating in a way? Because if I can
5 get their units in there then that's going to bring down
6 the full amount.

7 SENATOR BOWEN: I think you attacked your side of
8 it, but is there somewhere where you made a decision to
9 look at how that provision works?

10 MR. WINTER: Absolutely.

11 CHAIRMAN KAHN: Assemblyman Wright.

12 ASSEMBLYMAN WRIGHT: You've described a couple of
13 times the generators recouping costs. I think in the old
14 utility market, someone would make an investment, amortize
15 the debt over a period of time. They would then apply
16 what the debt service was and then they would make a
17 margin over that so that you amortized the debt over a
18 period of time.

19 If you're describing an environment where the
20 generator is trying to recoup his costs on a front-loaded
21 basis, then one of the other things I think that happens
22 is now you've got a totally different kind of generator
23 operating. Because if he's trying to make all of his
24 investment back over a period of time versus an amortized
25 debt, so that his debt service and profit was spread out,

1 then there's a totally different generator in place.

2 Whether or not it's cable television, or other
3 people who make capital investments, you amortize the
4 debt. You don't say I'm going to recoup my investment,
5 the whole thing. What you just said scares me, because
6 now that means that these people would look to, say, get
7 all their money back in three years or something.

8 MR. WINTER: I can't tell you what their strategy
9 is, but you are right. We've completely changed the
10 generating market in the way those people analyze risk.

11 On the other hand, I guess the analogy I would
12 look at is if I'm a retailer I may operate my business
13 just to break even, or even lose money for eight or nine
14 months out of the year, and when Christmas comes I make
15 enough money that will cover me the rest of the year. And
16 I'll amortize all my business, the store, the telephone,
17 everything over time.

18 And so I don't think any of them are coming in
19 and saying, "I'm going to make all my money in one month
20 or one year." What they are saying is they're very
21 concerned about the future. And, you know, how much of
22 this is real and how much of it is posturing, they have
23 made large investments.

24 They do want to have some reasonable amortized
25 rate of return on that money. And the market itself

1 forces them to even run at times to operate below their
2 cost. And they need to make those up.

3 CHAIRMAN KAHN: Mr. Winter, could I ask you to
4 change the subject and quickly address the other issues
5 that you had on the agenda. It is very helpful, but we do
6 have a few other things we have to get to. The RTO,
7 perhaps and --

8 MR. WINTER: Okay. The RTO is a very -- let's see
9 where do I start? I doubt that most people here are aware
10 of what RTO's are. Does anyone know what a RTO is? If
11 you all do, then I will dispense with a couple of minutes
12 of introduction. Let's assume that you do, but you need
13 refreshing.

14 The RTO is what is called a "Regional
15 Transmission Organization." FERC in their rules of 1988
16 and its Rule 888 and Rule 889 said that they were
17 concerned about transmission lines being used
18 discriminately for people to constrain trade interstate
19 wide, between states, and within states. And so they
20 passed a Rule 888 and 889 which, in essence, says that
21 you'll price your transmission at some fee. They didn't
22 even tell you what fee, just price it at that fee.

23 And, then, you had to publish that fee so that
24 anybody who wanted to buy on the transmission line that
25 was not being used, could do it at that price. As all

1 people who are trying to make money will do, it didn't
2 take folks too long to figure out that what you did was
3 you put in a very high cost of your transmission and then
4 you discounted for whatever constraints or self-interests
5 you wanted.

6 So they have watched this. It is done a lot to
7 open up the transmission system, but in the year 2000 they
8 recognized that there were still a lot of regional
9 problems. In other words, the very thing I talked about,
10 a line going out in the Northwest impacting California,
11 California having a problem that impacts the Southwest.
12 So they encouraged people, number one, to form ISO's,
13 which were more regional than just the State of
14 California, or in any one state that could eliminate some
15 of these issues of how do you convince Oregon to spend
16 some money that helps California and visa versa.

17 And that was not met with a lot of success for a
18 lot of reasons. California, for other reasons, went into
19 the ISO, but clearly it was for the other reasons. Now,
20 FERC, then, in the year 2000, hence, Rule 2000, has come
21 out and is encouraging these regional transmission
22 organizations. And by October of this year utilities have
23 to file on what they have done to develop an RTO.

24 Now, one -- as I have been in the west talking to
25 the different people deciding, you know, what is in the

1 best interest of California and also what is in the best
2 interest of the west, how should we organize this RTO?

3 Needless to say, when you're the high-priced
4 buyer and you're looked at as being large and somewhat
5 unfriendly in the marketplace, I haven't gotten any rounds
6 of thrills of people clamoring to join the California ISO.
7 And so I have been arguing that it is greatly to the
8 benefit of California to become a participant, or be a
9 much larger regional area.

10 Because this debate is going to get much more
11 federalized and as people in the northwest this winter are
12 looking at a 25-percent deficiency in serving their load,
13 and as we have lots of generators down here in the winter
14 that don't run, they're going to want to get power up
15 there. And you just need a larger umbrella organization
16 that does not override the State rights, but clearly can
17 bring to the perspective of interregional discipline.

18 And I tend to liken this to the freeway system.
19 You know we've all driven freeways and then suddenly get
20 to -- I better not use Boise -- but some small town and
21 you get stuck back on the country road and you have to
22 drive through the city and then back to the freeway.
23 Well, I think there's an overriding route that just says
24 that we have to have a larger infrastruc system that is
25 to the benefit of the Western United States.

1 I have to tell you that I've been very
2 unsuccessful in convincing anybody that, while everybody
3 will tell me, you're absolutely right, but you're way out
4 ahead of everybody and, therefore, nobody is ready to go
5 there. I'm enough of an optimist that I keep beating on
6 the door.

7 I will file for the California ISO to be a RTO.
8 I quite honestly think that will be an up-hill battle,
9 because as FERC looks at these issues they want an
10 interstate region, not just a one state, because then
11 suddenly your interest doesn't take care of the seams
12 between Oregon and California and California and Arizona.

13 CHAIRMAN KAHN: Okay. Thank you. Just one second.

14 MEMBER WILLISON: Can I will ask a question in the
15 meantime?

16 MR. WINTER: Sure.

17 MEMBER WILLISON: Remind me, there are a couple of
18 RTO's already formed now?

19 MR. WINTER: No. I do not believe that there are
20 any RTO's. There are other ISO's.

21 MEMBER WILLISON: Just back to the cap issue, the
22 ISO's, they have established caps as well and have they
23 had the same problems?

24 MR. WINTER: Clearly PJM has a cap of 1,000. They
25 had generators selling to the midwest when the price there

1 was 7,000. They cover Pennsylvania, New Jersey, and
2 Maryland, I think. So they're interstate. They face the
3 same problems, but when you look at the different ISO's
4 you really have to look at what is the total structure.

5 The ISO, PJM is more of a pool-type company. And
6 so they optimize, they have some other rules. New York is
7 an ISO. It has a different set of rules. New England is
8 another one. And Canada has an IMO, that's the same
9 thing.

10 But all of them have little different rules in
11 their makeup and how those interplay with each other
12 oftentimes is the root of where your caps are and what you
13 can do.

14 CHAIRMAN KAHN: One more question, but the Reporter
15 needs a break.

16 MR. ROZSA: I want to get back to the connection
17 between price caps and reliability and your decision last
18 night. I want to pursue the line of questioning which I
19 started earlier:

20 It seems to me that in that conversation which we
21 just had, what you said to me was that because you had the
22 ability to go out of market to purchase supplies and that
23 was not restricted by the price caps that you could get
24 the supplies that were needed to ensure reliability.

25 MR. WINTER: If they're available.

1 MR. ROZSA: Okay. Now, of course, it's always if
2 they're available.

3 MR. WINTER: Right.

4 MR. ROZSA: So it's not a question. So in other
5 words, are you saying that the price cap doesn't hurt your
6 ability to maintain reliability?

7 MR. WINTER: I would hesitate to go that far to say
8 that --

9 MR. ROZSA: How would you characterize it?

10 MR. WINTER: Okay. I would characterize it if we
11 constantly have a price of 250 and let's say generators
12 out there in other states constantly know --

13 MR. ROZSA: I'm talking about people outside of
14 California.

15 MR. WINTER: Outside California.

16 MR. ROZSA: Yes.

17 MR. WINTER: Because, remember, Senator Peace also
18 made the point that maybe it's time that we look like
19 Texas, which is we develop all of our generation inside.

20 MR. ROZSA: We're not that way. Let's talk about
21 the current situation.

22 MR. WINTER: Okay. So if you start looking at the
23 utility now who is trying to hedge himself in the
24 future --

25 MR. ROZSA: Which utility, is this the inside

1 utility, or is this the utility --

2 MR. WINTER: The inside utility. Say, somebody
3 trying to serve load in the State of California.

4 MR. ROZSA: Right.

5 MR. WINTER: If we have a price cap of 250 and they
6 feel restricted by that that they can't go out and
7 purchase the hedging, then I'm in the market --

8 MR. ROZSA: Wait a second. Now, I noticed that the
9 utilities voted last time for the 250 cap. So it's pretty
10 clear that they didn't feel restricted by the 250 cap. So
11 let's not go down that road.

12 So what I want to understand is: What are the
13 practical implications for the ISO on reliability of any
14 price cap since you have the right to go and buy supplies
15 out of market?

16 MR. WINTER: The only thing that I would say is that
17 is if I'm constantly going out of market and paying
18 whatever the price is going to be, you are going to see
19 these price spikes again. And it's going to be me as the
20 regulator, rather than a market --

21 MR. ROZSA: It is you as the regulator already that
22 is causing these price spikes with the \$750 cap. So what
23 you're saying is that there's no practical limitation on
24 your ability to maintain reliability with these price
25 caps.

1 MR. WINTER: I would have to agree with that.

2 MR. ROZSA: Thank you very much. Now, then, tell me
3 why it is that you believe and, of course, I'm just asking
4 for your opinion, as to why the Board voted for \$500 price
5 caps last night as opposed \$250 price caps last night if
6 you're going to have price caps and you have this ability,
7 what difference does it make to that capability?

8 MR. WINTER: Okay. I think there's a couple things.
9 While I may have the immediate ability to go out and pay
10 whatever price there is, one of the other things we're
11 trying to do with this market is to incite people to build
12 generation here and take that risk that we have now passed
13 from the --

14 MR. ROZSA: All right. I understand that. Now,
15 have you made the judgment that a \$500 price cap is needed
16 to incite construction of utility generation? I haven't
17 seen the analysis by the ISO. As a matter of fact, we had
18 testimony from generators that they were happy with 250,
19 that they could make money all day long at 250. In fact,
20 people were reporting that their business decisions didn't
21 depend upon a price cap at all.

22 So, you know, in general, you would say, yeah,
23 you want to incite people to do it. So did you make the
24 judgment -- I mean on what basis did you make the judgment
25 that a \$500 price cap was the appropriate price level as

1 opposed to a \$250 price cap? Was there any analysis
2 provided to the ISO that said that that should be the
3 price cap?

4 MR. WINTER: No, but I think I would refer you back
5 to your comment that if I had a generator and he could get
6 \$250 day in and day out --

7 MR. ROZSA: They don't get it day in and day out.
8 They understand that they get it under shortage
9 conditions.

10 MR. WINTER: Okay. I didn't have them present that
11 information to me. What I am looking at is a couple of
12 things. One, the market, back when we passed the motion
13 we said we were raising the cap to 750 for a couple of
14 reasons. One, there was nothing magic about that number
15 other than it was a number.

16 Number two, it would release us to try to
17 encourage more demand side management into the market,
18 because those folks are telling us that until we get up to
19 a price of 3, 4,000 it really doesn't pay to take an unit
20 off. Peakers were saying that they needed that price.
21 And since I know how I came up with the 250, clearly if
22 natural gas prices have doubled, it's above 250.

23 MR. ROZSA: Well, actually, the natural gas price
24 increase has added about \$25 a megawatt hour to the cost
25 of electricity. It has not caused it to double. It's

1 added about \$25 a megawatt hour. And I know how that
2 original \$250 was developed.

3 It was based upon a very inefficient plan,
4 funding very expensive fuel, propane as a matter natural
5 gas. And then \$100 was added to that to get to the \$250
6 price cap. And everybody said that that was a pretty good
7 price, that they could do pretty well on.

8 So what I'm trying to understanding is you didn't
9 have any sort of analysis from your staff that said that
10 the generator needed a \$500 price cap in order to be able
11 to do that. With regard to DSM, this particular motion
12 reserved the right for DSM to receive \$750. So that's not
13 a particular issue.

14 So I'm still trying to understand the
15 justification behind the \$550 price cap as opposed to the
16 250. Can you explain the logic that your board used in
17 doing this, because it doesn't look to me that they used
18 much logic. It looks to me like what this is about is
19 rents. And I --

20 MR. WINTER: Yeah, I think -- I didn't hear what you
21 said, but let me answer that. I guess there's something I
22 take very, very personal in negotiations. And one of
23 those is in the board meeting, which I tried to say just a
24 minute ago, we said we were moving to the 750 to try and
25 allow the market to send the correct signals for future

1 generation being built.

2 The second thing we said was if we determine that
3 we are not going -- that the market is not working, we
4 will remove -- bring that down to 500. Now, in that
5 motion a lot of people -- and I don't know who all the
6 people are, but I certainly got a lot of phone calls,
7 saying that they developed their hedging markets based on
8 the reliance on the 750. I said, okay, that's fine. You
9 did that on 750, but I said I might take it to 500.

10 Now, if you tell me to go below that, quite
11 honestly, I think I have now reneged on the deal that I
12 made with the community.

13 MR. ROZSA: When you raised your price caps from 250
14 to 750, weren't there a lot of people that made deals
15 based upon the \$250?

16 MR. WINTER: I don't know, possibly.

17 MR. ROZSA: I would imagine. Did you think about
18 the fact that you might be reneging on them when you went
19 from 200 to 750?

20 MR. WINTER: Certainly, it entered my mind.

21 MR. ROZSA: I don't remember it being a part of the
22 discussion. And -- I think -- I think you've said exactly
23 what the truth is here.

24 CHAIRMAN KAHN: Okay. I'm going to exercise the
25 prod of the Chair, the remaining items on the agenda have

1 been supplied in documentation and were well covered. And
2 we do have a lot of things we need to cover in the closed
3 session. So with the permission of the other members, I'm
4 going to close the public session and we'll reconvene in
5 ten minutes to begin the closed session. Thank you very
6 much.

7 (The public session concluded at 12:33 p.m.)

8 ---oOo---

9 (The public session was called back to order
10 at 2:24 p.m. and adjourned at 2:25 p.m.)

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REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)
) ss.
COUNTY OF SACRAMENTO)

I, MARY R. GALLAGHER, certify that I was the
Official Court Reporter for the proceedings named herein,
and that as such reporter I reported in verbatim shorthand
writing those proceedings; that I thereafter caused my
shorthand writing to be reduced to typewriting, and the
pages numbered 3 through 88 herein constitute a complete,
true and correct record of the proceedings.

IN WITNESS WHEREOF, I have subscribed this
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July, 2000.

MARY R. GALLAGHER, CSR #10749